

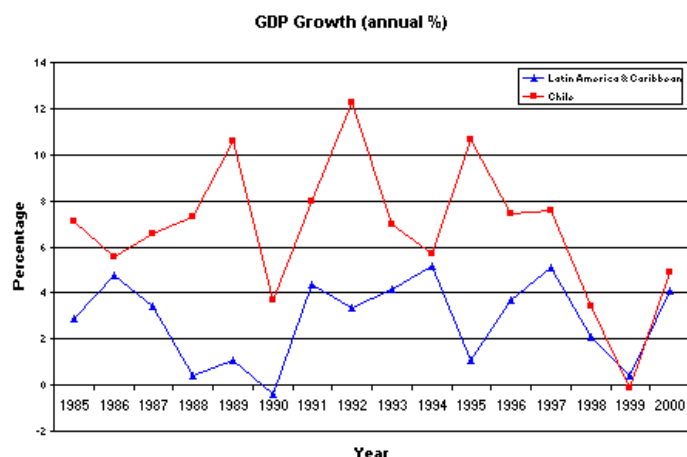
Chile as a Template

Sidney Weintraub

Latin America and the Caribbean went through two successive dreadful economic decades, the 1980s and 1990s, and the horror is continuing in the first two years of this century. The political situation has been much better, in that authoritarian and military regimes were discarded in favor of democracies even during the worst economic years of the 1980s and democracy continues to this day as the most favored form of government. These are tarnished democracies in some cases, but there has been no the reversion to the military takeovers that pessimists regularly predict when the situation in many countries looks particularly terrible. However, horrible economic outcomes have their political consequences, as we are seeing in one election after another in the region.

As observers of the Latin American scene know, the major exception to the economic catastrophe that dominated the regional scene over the past two decades was Chile. The positive economic performance of Chile compared with the rest of the region is shown in Figure 1. A few other countries have had considerable growth in the 1990s—Costa Rica, El Salvador, the Dominican Republic, Trinidad and Tobago, and Mexico—but none as consistently as Chile over the full 1985 to 2000 period.

Figure 1



Source: *World Development Indicators* (Washington, D.C.: World Bank 2002).

It is important to understand the policies that made Chilean economic performance unique in Latin America. Chile suffered through an economic collapse in 1982, but the response was not to jettison the liberal economic philosophy that had been put in place a decade earlier by the Pinochet regime, but rather to modify and even strengthen it. By liberal, I have in mind fiscal prudence, consistent monetary policy that aims at keeping inflation low, an exchange rate that is now cleanly floating, significant privatization of government enterprises, an open import market, encouragement of exports (which now comprise 43 percent of GDP), targeted social programs during the difficult years, and a respected judicial system. Due mainly to its steady growth year after year, Chile reduced its poverty rate from 45 percent of the population in 1985 to 21 percent in 2000. The economic reforms were originally put in place by a dictatorial regime, but the policies then continued, with some changes at the margin, when democracy was restored to Chile in 1990.

In the last few years, Chile's economic performance has been less stellar than earlier. There was actually a slight downturn in 1999, due perhaps to playing it ultra safe by tightening monetary policy after the Asian crisis, and GDP growth this year is likely to be about 2 percent—not bad in the Latin American context, but a far cry from the consistent 7 to 8 percent growth performances of the heyday years. Much of the current problem can be attributed to the serious deterioration in the terms of trade represented by the low prices for copper exports (which still account for about 40 percent of Chile's total merchandise exports) and the high prices for oil imports. The business community is restive about the economic leadership being provided by President Ricardo Lagos, and the president is reacting to this. When I was in Chile a few weeks ago, Lagos said he would consider a pro-growth plan to institute a number of microeconomic stimuli suggested two years earlier by the Sociedad de Fomento Fabril (SFF), the large industrial organization of the private sector, but the acceptance was greeted with considerable cynicism. It came on the eve of the large annual dinner of the influential SFF at which President Lagos was to be the main speaker. Chile's electorate is fairly evenly divided between the *concertación* (or alliance) of Christian Democrats, Socialists, and other parties

that have won the presidency in each of the three elections after democracy was restored, and conservative parties. Lagos is a Socialist.

The larger context in which to analyze the Chilean scene is how its economic performance is likely to affect decisions of much of the rest of the region. Chile has succeeded with a liberal economic policy, while most of the rest of Latin America is failing with less rigorous adherence to liberal economic policies. Argentina ran fiscal deficits that were excessive for maintaining its fixed exchange rate; Brazil has contracted a dangerously high level of debt; Mexico used its exchange rate as the anchor to control inflation, which came unstuck in 1994; Venezuela put its trust in the hands of a president with little sense of economic fundamentals. The argument that globalism necessarily prejudices the development aspirations of developing countries is clearly contradicted by the Chilean performance; Chile globalized by passionately seeking foreign investment and promoting exports and succeeded in both, even as it outstripped the rest of the hemisphere in its economic growth.

If the Chilean model falters now, however, this pesky (to globalization opponents) pro-globalization success will lose much force. Latin Americans have pronounced the “Washington consensus” as dead for many years now, but there was Chile adopting most of the policy elements of the consensus and doing splendidly. Luis Inacio “Lula” da Silva won the recent election by calling for changes in the Brazilian economic model. Lucio Gutierrez, who emerged politically as an antimarket leftist, is now favored to win the presidency in the runoff in Ecuador. Evo Morales ran against the liberal economic model and came close to becoming the president of Bolivia. Hugo Chávez became president of Venezuela even as he expressed admiration for the Fidel Castro model in Cuba.

All these people stated a desire to do away with the liberal economic model, although they have been imprecise as to what their alternative would be. What they have argued is that the economic situation of the majority of the population in each of their countries has worsened under the liberal (they would use the word “neoliberal”) development model, and therefore “it is time for a change.” This is a potent argument because the situation of a majority of the population has stagnated.

The United States has been the most vociferous advocate of liberal economic policies, both under President Clinton and even more now under President Bush. The proposal for a Free Trade Area of the Americas (FTAA) is predicated on liberal trade policies. Chile’s success in forcing most of its producers to compete with imports and to exploit Chile’s geography and assets in penetrating export markets has made its policies far more influential than its relatively small population would warrant.

If Chile’s economy continues to falter, the consequences could be considerable throughout the hemisphere. In Chile, itself, the

shift would most likely be from the largely centrist or center-left *concertación* to more conservative leaders, and, if this should occur, the liberal economic policies would remain intact or even be strengthened. Elsewhere in the hemisphere, however, an extended slowdown in Chile’s economy would more likely lead to antiliberal economic pressures. The antiglobalists could then assert, “See, I told you so.” Just what the new policies would be is hard to predict given the vague nature of the proposals so far, plus the reversion to economic orthodoxy by some of the most fiery advocates for change as they succeed politically—such as Lula and Lucio Gutierrez.

This analysis has implications for U.S. policy. The sidetracking of high-level attention to Latin America, which followed the events of 9/11, could be costly. Continued economic stagnation in the region would not only prejudice U.S. exports and slow capital flows to the region, but would most likely lead to political changes that would not be welcome in Washington. The FTAA itself could come under pressure because it is premised on a liberal development model that might not hold sway in the future.

The logical conclusion of this analysis is that the top level of official Washington must be less rigid in its policies. Countries whose fundamental economic policies are sound, like Chile, are going through a hard period; the slowdown in the developed countries leads to magnified repercussions in the developing countries of Latin America; and U.S. goals in the hemisphere will not be achieved if the region continues to stagnate. Put in programmatic terms, the U.S. market must be more open to their goods and services, and the United States should show a less grudging disposition to help financially when crises erupt.

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